

Here's Help with Financing Decisions – March 1995

In view of the rapidly changing health care delivery system of the 90's, determining whether various methods of financing equipment are appropriate for the needs and plans of a facility has to be a team effort. Many people could, and should, be involved.

Let's take the leasing option as an example. The decision has already been made to acquire new equipment. The administrator may have been a decision-maker or a consultant (or both) in this process, along with medical, technical, marketing, financial, engineering and other internal personnel. Outside consultants should most likely be used, including vendor sales and engineering personnel, marketing consultants referring physicians and secondary resources, such as market projection reports and equipment purchasing advisory services.

Much of the groundwork for the financing decision has already been laid in the equipment selection process, and if time has been invested in recording and compiling the data received from various resources, a review of this information will offer some direction.

Marketing and Technology

First, the marketing data collected during the selection process should reveal what the expected useful life of the equipment will be. This depends on many factors, including current and projected revenues, patient volume, impact of competition and managed care contracts, and future reimbursements.

Hopefully, the projected technical life of the equipment was of primary concern early in the selection process. Reviewing that information can now be helpful, as longer-life assets can be financed over longer periods, reducing payments and optimizing cash flow, with the ultimate intent to purchase equipment. If the equipment is highly computerized and rapidly evolving, such as a chemistry analyzer, technological obsolescence may be the driving factor, making a short-term (five to seven years) lease a more logical choice.

Free Advice

The consultants one might most likely enlist for the purpose of projecting technical life are probably free, or at least inexpensive. These include equipment manufacturers, internal engineering staff, technical and medical personnel and information from trade publications.

Trade shows are a great source for gaining insight into technology, as the manufacturers usually display their "works in progress". Manufacturers today are sensitized to the economic realities of health care reform, so they can be of substantial aid. Be sure to check out competing manufacturers as well, since new technical introductions are quickly adopted by others.

Physicians and engineers are sometimes overlooked in financing decisions, but they can lend insight into the technology and its expected life span. This group can also be instrumental in projecting the cost to operate and maintain the system, thereby adding a key element to the financial model.

Medical staff members should be consulted in the marketing research phase, and input should be studied to see what they project to soon be hot. If they see a new procedure on the horizon that certain equipment cannot readily accommodate, it may be necessary to finance the equipment with flexibility that allows for upgrades or replacements before the end of the original contract. This is an area of concern for the accountants as well, so don't overlook that resource.

Chief Financial Officer

If you work in a large facility, the organization's chief financial officer (CFO) is a good source of information, not only about budgeting and negotiating an acquisition price, but also in interpreting the lease rates in light of the many different payment options that may be offered.

The CFO can be an excellent resource in the determination of the real cost of the lease over time. And, not to minimize the importance of a CFO's input, several computer programs contain financial analysis tools, as do financial calculators.

Lease Company Representatives

Asking a lease company for advice may be a bit like asking the fox to guard the hen house, but the financing industry is always introducing new concepts that can be of great advantage in the decision-making process.

To satisfy and protect its investors, the lease company must keep abreast of accounting rules for different types of financing contracts. Since it is in the lease company's best interest to conform to the Federal Accounting Standards Board, it will offer leases that conform to the latest revisions and interpretations, as well as the latest Internal Revenue Service rulings.

Lease differentiation among lease companies is standard in any marketing effort, and a company will use a variety of techniques to make its lease look more attractive than others. This is where most of the other consultants are important.

Attorneys

Your attorney may or may not have experience in reviewing leases. Make sure you have access to an attorney who is involved in such work on a regular basis. Virtually any attorney can review your lease proposals, but you probably won't want to pay someone for time to study and learn legal concepts in each lease. The first discussion you should have with an attorney is about the purpose of the lease.

Since the advent of word processors and laser printers, it is extremely difficult to differentiate changes made in a lease contract offered today from one offered yesterday. Changes could be of huge significance, so contracts must be proofread. One option for those with the right hardware is to scan the documents into a word processing program and use a "compare" command.

If the lease is being used simply as an equipment financing vehicle, the legal review is not terribly complex. The most important areas to review will pertain to responsibilities of parties and what the upgrade and buyout provisions contain. An attorney should look for "hooks" that lock a buyer into or out of certain courses of action.

If the lease is used, however, to solve another problem, such as physician self-referral, attorney review becomes more complex and more important. The attorney in this case must be well-versed in the legislated Medicare and Medicaid Fraud and Abuse language within the Omnibus Budget Reconciliation Act of 1993 (OBRA '93), commonly known as "Stark II." Leasing is one of the "safe harbors" in OBRA '93 that allows the continued ownership and referral under specific conditions. An attorney with lease contract experience should be consulted in the design and writing of the lease document.

Appraisers

Under the Uniform Standards of Professional Appraisal Practice (USPAP), an accredited appraiser cannot act as an advocate for any client. An appraiser, who concentrates on the medical business can be very useful in reviewing leases and finding clauses or concepts that may not be fair or, in some cases, may not meet the needs of the situation.

Appraisers review many leases, as appraisal services are specifically required in many cases. They can also be employed to review the various leases for Stark II purposes, upgrade and modify provisions and fair market value buyout language. Working with an attorney, CFO and other consultants, the appraiser can assist in making sure the wording in the document is equitable to both parties.

Appraisers are used at both ends of a true lease. Prior to writing the lease, they are used to provide an estimate of future residual value to the lease company. This estimate is then used in the lease company's calculation of anticipated profits and cash flows. Even though the true lease must offer a "fair market value" buyout at termination, this projection helps the lease company protect its investment.

A professional, independent, arms-length appraiser should be used to determine fair market value at the end of the lease. Needless to say, this value can be substantially different from that predicted at inception. Lease companies often try to use their internal appraisers for the determination of fair market value, but these appraisers are definitely not arms-length or objective. The appraiser must be one who would arrive at the same conclusion of value whether hired by the lessor or lessee. An appraiser can sometimes work as an arbitrator, attempting to meet the needs of both parties without bias. A simple method of ensuring fairness is to choose the appraiser together and share the cost.

In some cases, separate appraisers for the lessor and the lessee are hired and asked to agree on a fair market value. Should a dispute arise, a third appraiser may be employed to determine the asset value (this usually occurs only in substantial transactions). If the lessee does not wish to purchase the asset, but would rather continue to lease it, the lessor may then negotiate a new lease based on the estimated fair market value and economic life at the time of renegotiations. As a final alternative, the lessor may sell the asset to another party, usually at "orderly liquidation value" (commonly referred to as "wholesale value"), or far less than fair market value.

Look for credentials in the appraiser selection process. The American Society of Appraisers is the largest and best known society that provides training and certification for its appraisers, as well as mandating strict adherence to USPAP and to its own code of ethics.

A growing trend in the industry is to put an arbitration clause in the lease contract. The American Arbitration Association, a non-profit organization specializing in dispute resolution, is an excellent group to join. The group's language regarding arbitration can eliminate a lot of legal expense in times of trouble.

Conclusion

It has been said that a consultant is someone who, when asked what time it is, will look at your watch, tell you the time and bill you for it. To some extent this is true. Often the job of the consultant is to take your information and perceived needs and assist you in making decisions that help you reach your goals. These outside experts, who daily encounter the types of problems you face only infrequently, can lend perspective and timesaving insight.

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